Vertex Planning Partners LLC

Quarterly Market Review

Q3

Third Quarter 2022

Economy

Monetary Policy

What's Happening:

There have been 5 consecutive rate hikes in 2022, including 75 bps (2.25-2.5%) in July and a further 75 bps (3-3.25%) in September[1].

The Fed accelerated Quantitative Tightening in September to $95 billion per month, compared to $45 billion previously[2]. The process aims to reduce the $9 trillion balance sheet it has amassed since the Global Financial Crisis, with a little over half proactive measures to reduce the impact of the COVID lock downs in 2020[3].

What does this mean?

The Fed aims to tighten financial conditions to combat decades high inflation. By increasing interest rates, the Fed raises the cost of economic activity, decreases the wealth affect, thereby slowing economic activity and price inflation. The danger is always that rate increases have a lagging effect, and by over tightening the Fed can push the economy into a recession.

Fiscal Policy

What's Happening:

Passing of the Student Debt Relief Plan[4] and Inflation Reduction Act[5]

What does this mean?

Congress passed two laws aimed at achieving campaign promises of reducing student debt burdens, transitioning the US economy away from carbon-based energy, targeting corporations and high-income earners for additional taxation, and capping prescription drug prices. Only time will tell if these actions have positive impacts on inflation and government spending.

Economy

Geopolitics

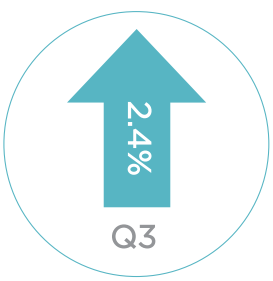
What's Happening:

The war between Ukraine and Russia continues to have a major impact. With the recent sabotage of the Nordstream 2 pipeline, there are major concerns on how Europe and particularly Germany will meet their energy needs over the winter.

What does this mean?

Russian sanctions have led to inflated natural gas prices due to shortages, and countries are forced to bring back coal powered plants and resort to other extreme measures. We expect this to have severe impact on Europe's economy.

GDP



What's Happening:

GDP growth in Q3 2022 is expected to rise by 2.4%.[6]

What does this mean?

One of the difficulties for 2022 is the disconnect between markets and the economy. Even though equities and bond markets have performed poorly, the underlying economy has remained strong with low unemployment and nominal GDP growth. The difference has been inflation outpacing economic growth, and the Fed's strong reaction to reigning it in.

Markets

Equity

Equity Markets continued their downward trend in the third quarter, with US equity markets down over -4.88% for the S&P 500. Foreign markets fared worse, with International Markets declining -9.80% and Emerging Markets down -11.42%. [7]

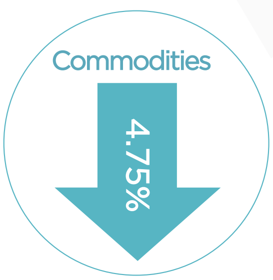
Inflationary pressures, dollar strength, and a hawkish Fed led to concerns about valuations and the potential of a global recession caused by policy over tightening.

Fixed Income

As the Fed has continued their rate hikes, bond markets continued their historic fall, experiencing declines of -4.75% for US Bloomberg Aggregate Index and over 14.61% for the year [7].

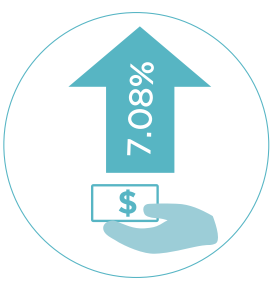
A combination of rate hike expectations and high inflation provided an exceptionally poor environment for fixed rate instruments.

Real Assets



The Bloomberg Commodity index fell -4.75% for the second straight quarter after the initial shock following the Russian invasion of Ukraine[7], as investors continued to shift to concerns on the Fed tightening the economy into a recession.

Currency



Dollar[8] strengthened an additional 7.08% in Q3, bringing the total return for the year at 17.25%. As a positive, the surge in dollar strength has helped put a lid on commodity prices, but also has increased downward pressure on foreign asset prices.

Current Strategy

Reasons To Be Optimistic

Bull markets last longer than bear markets, and since 1966 the average bear market has lasted 446 days (1.25 years) with declines of 38.4% while bull markets last 2069 days (5.5 years) and return 209.2%[8]. Since the peak in January, the current bear market is 270 days old, surpassing 1966 and 1987 in duration. If the Fed is successful at reigning in inflation, current yields and equity valuations are particularly attractive for long term investors.

Reasons To Be Cautious

Aggressive policies from the Federal Reserve to tighten financial conditions and lower inflation have rarely been positive for asset prices, at least in the short term. In situations where there are supply imbalances, the only available tool for the Fed is to reduce demand. One potentially negative outcome is stalling economic growth with persistent inflation (which is negative for both stocks and bonds).

Current Strategy

Strategy for Q3 2022

We have further reduced risk exposure through increased allocations to fixed income as yields have risen, and through tilting away from market cap weighted equity, preferencing companies with sustainable cash flow and dividends to help ride out the volatility.

With the risks of recession rising, we have also reduced long only commodity exposure as slowing economic activity reduce their attractiveness. Instead, we increased exposure to systematic strategies focused on macro-economic trends, investing in asset classes (equities, fixed income, commodities, and currencies) and strategies which can benefit if financial markets continue deteriorating.

As the Fed continues be hawkish in their outlook for increasing rates at the front end of the curve, we have increased our positions in floating rate treasuries which provide both price stability and higher forward yields. Credit markets are beginning to look attractive based on historical yields and spreads, but we prefer to wait until the rhetoric out of the Fed begins to signal a correction from their current aggressive stance.

In 2022 we continue to favor tax managed strategies for taxable accounts to take advantage of increased market volatility and to help offset potential higher capital gains rates.

Source

1) https://www.federalreserve.gov/monetarypolicy/openmarket.htm

2) https://www.bloomberg.com/opinion/articles/2022-08-31/federal-reserve-quantitative-tightening-fallout-should-be-limited?leadSource=uverify%20wall

3) https://www.ft.com/content/2496105a-d211-4abe-ab5d-46a91876428f

4) https://studentaid.gov/debt-relief-announcement/one-time-cancellation

5) https://www.crfb.org/blogs/whats-inflation-reduction-act

6) https://www.atlantafed.org/-/media/documents/cqer/researchcq/gdpnow/RealGDPTrackingSlides.pdf

7)

	YTD	Q1	Q2	Q3
S&P 500 Total Return	-23.87%	-4.60%	-16.10%	-4.88%
S&P 400 Total Return	-21.52%	-4.88%	-15.42%	-2.46%
S&P 600 Total Return Bloomberg	-23.16%	-5.62%	-14.11%	-5.20%
MSCI ACWI Ex USA Total Return	-26.18%	5.33%	-13.54%	-9.80%
MSCI Emerging Markets Total Return	-26.89%	-6.92%	-11.34%	-11.42%
Bloomberg US Aggregate	-14.61%	-5.93%	-4.69%	-4.75%
Bloomberg Commodity Index	12.42%	25.45%	-5.92%	-4.75%
ICE US Dollar Index	17.25%	2.79%	6.52%	7.08%

8) https://www.theice.com/products/194/US-Dollar-Index-Futures

9) https://www.schwab.com/learn/story/market-correction-what-does-it-mean#:~:text=There%20have%20been%2024%20market,%2C%202007%2C%20and%202020)

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All indices are unmanaged and may not be invested into directly.

All investing involves risk including loss of principal. No strategy assures success or protects against loss.

Stock investing includes risks, including fluctuating prices and loss of principal.

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and bonds are subject to availability and change in price.

Dividend payments are not guaranteed and may be reduced or eliminated at any time by the company.

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